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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 29

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

ANNIE M. PFEIFFER.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

PETITION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE.

J. HARRY COVINGTON
JOHN THOMAS SMITH
PAUL E. SHORB
DAVID SHER

Washington, D. C.
October 19, 1937.

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The undersigned respectfully petition this Court for leave to file this brief as *amicus curiae* in the above entitled suit. The Solicitor General of the United States and counsel for the respondents have assented to the filing of this brief, and their written assents are filed herewith.

J. HARRY COVINGTON,
JOHN THOMAS SMITH.

Washington, D. C.
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BRIEF OF AMICUS CURIAE.

The sole question considered in this brief is whether Section 115(f) of the Revenue Act of 1928 (Act of May 29, 1928, c. 852, 45 Stat. 791) exempts all stock dividends from income tax.

The facts upon which this case arises are not in dispute and are fully set out in the briefs of the respective parties. This brief, therefore, will confine itself to the argument on the above question.

SUMMARY OF ARGUMENT.

I.

The term "stock dividend" used in Section 115(f) of the 1928 Act has always meant a distribution of the stock of a corporation among its stockholders as a dividend. This clear and simple definition has constantly been used not only by the text-writers and the courts, but also by the Treasury Department and by Congress itself. Under these circumstances, the Court should apply the familiar canon of construction that where the language of a statute admits of but one meaning, it will be enforced according to its terms. *Wallace* v. *Cutten*, 298 U. S. 229, 237.

II.

The plain meaning of the statute is confirmed, if confirmation be necessary, by the actual debates in Congress on the various bills dealing with the exemption of stock dividends. Those debates show a reluctance to exempt stock dividends, but a clear intention to grant them full exemption because of the belief that the decision in *Eisner* v. *Macomber*, 252 U. S. 189, left no alternative,—a belief that was fostered both by contemporary discussions of that decision and by the decisions of the Treasury Department.

The plain meaning of Section 115(f) of the 1928 Act is still further confirmed by the change in the language of that section in the 1936 Act. The latter exempts only those stock dividends which are not income under the Sixteenth Amendment, and is strong evidence that the law was changed by the 1936 Act. *Brewster* v. *Gage*, 280 U. S. 327, 337. The legislative history of the 1936 Act indicates clearly that a change in the law was intended, rather than a clarification of the old law, and this indication is confirmed by the Act itself in Section 115(h).

The Government's principal argument is that the exemption of stock dividends was purely a recognition by Congress of the constitutional limitation announced by *Eisner*

v. *Macomber, supra.* Conceding this to be true, the answer is that the constitutional limitation was thought to cover *all* stock dividends. Moreover, the Government attempts to impart to Congress information which it did not have in 1921 and interprets the statute in the light of later events rather than in the light of circumstances that were assumed to exist at the time the statute was enacted. This Court has frequently held that this may not be done. *Merritt* v. *Walsh,* 104 U. S. 684, 700; *Platt* v. *Union Pacific R. R. Co.,* 99 U. S. 48, 63-64.

ARGUMENT.

I.

The Plain Meaning of the Provision Must Be Obeyed.

The language of Section 115(f), "A stock dividend shall not be subject to tax", is clear and unambiguous. There never has been any doubt that a stock dividend, in contrast to a cash or property dividend, means a distribution by a corporation of its own stock as a dividend to its stockholders. "A stock dividend is what the term itself implies, a distribution of the stock of the corporation among the stockholders as a dividend." Thompson on Corporations, Vol. 7, Section 137. "A stock dividend is a dividend payable in reserved or additional stock of the corporation instead of in cash or in property." Fletcher, Cyclopedia of Corporations, (1919 ed.) Vol. 6, page 6122. These and similar definitions have frequently been applied by the courts. See *Gray* v. *Hemenway,* 212 Mass. 239, 242 (1912); *DeKoven* v. *Alsop,* 205 Ill. 309, 314 (1903); *Union & New Haven Trust Co.* v. *Taintor,* 85 Conn. 452, 455 (1912). Any suggestion that the scope of the term "stock dividend" is limited to a dividend of common stock to common stockholders is quickly dispelled by a simple *reductio ad absurdum.* Suppose that an early Revenue Act had provided that "a stock dividend *shall* be included in the computation of gross income". Would anyone have dared to contend that the term em-

braced only a dividend of common stock to common stockholders and that a dividend of preferred stock to common stockholders, for instance, was outside its ambit?

Prior to the original adoption of the stock dividend exemption in 1921, the Treasury Department had used the term "stock dividend" to describe any issue of stock by a corporation to its stockholders, whether of the same class or not. T. D. 3052 and 3059, 3 C. B. 38 (August 1920). "A stock dividend paid in true preferred stock is exempt from tax the same as though the dividend were paid in common stock." O. D. 801, 4 C. B. 24 (January-June 1921). It used the term in that sense after the enactment of the exemption. Article 1548 of Regulations 62, 65 and 69; Article 628 of Regulations 74 and 77; Article 115-8 of Regulations 86. It continues to use the term in the same sense after *Koshland* v. *Helvering*, 298 U. S. 441. "The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution . . ." Article 115-7 of Regulations 94 (Nov. 12, 1936).

Congress itself has always used the term "stock dividend" interchangeably with "dividend in stock". Section 2 (a) of the Revenue Act of 1916 (Act of September 8, 1916, c. 463, 39 Stat. 756) provided that the term "dividend" should mean "any distribution . . . in cash or in stock of the corporation, . . . which stock dividend shall be considered income to the amount of its cash value". Section 31 (a), added to the 1916 Act by Section 1211 of the Revenue Act of 1917, (Act of October 3, 1917, c. 63, 40 Stat. 300), and Section 201 (a) and (c) of the Revenue Act of 1918 (Act of February 24, 1919, c. 18, 40 Stat. 1057), contain similar provisions. H. R. 14197, adopted by the House in the 2nd Session of the 66th Congress, contained the same significant phraseology—"A dividend paid in stock of the corporation (hereinafter called 'stock dividend') . . . ". Section 115(f) of the Revenue Act of 1936 (Act of June 22, 1936, c. 690,

49 Stat. 1648), adopted after *Koshland* v. *Helvering,* still uses the term in the same sense.

Throughout the kaleidoscopic statutory and administrative changes wrought by *Towne* v. *Eisner,* 245 U. S. 418, *Eisner* v. *Macomber,* 252 U. S. 189, and *Koshland* v. *Helvering,* the meaning of the term "stock dividend" remained ever constant as a description of that category of corporate dividend in which stock of the corporation rather than cash or property is distributed to the stockholders.

The definitive and unmistakable words, "a stock dividend shall not be subject to tax", call into play the familiar canon that where the language of a statute admits of only one meaning, the court will enforce it according to its terms. *Helvering* v. *City Bank Farmers Trust Co.,* 296 U. S. 85, 89; *Crooks* v. *Harrelson,* 282 U. S. 55, 58; *Thompson* v. *United States,* 246 U. S. 547, 551; *United States* v. *Goldenberg,* 168 U. S. 95, 103; *Sturges* v. *Crowninshield,* 4 Wheat. 122, 202-203. The principle is not a product of pedantry but of a keen realization of the method most surely calculated to carry out the legislative intent. What Congress says is the best evidence of what Congress means.

Wallace v. *Cutten,* 298 U. S. 229, is a fine symbol of judicial fidelity to legislative language. Section 6(b) of the Grain Futures Act provides that if the Secretary of Agriculture has reason to believe that any person "is violating" any provision of the Act, the Secretary may serve a complaint upon that person requiring him to show cause why he should not be suspended from trading. The complaint in the case alleged violations which had been completed before the complaint was filed. The Government argued that, since violations by their very nature could not be detected during the course of commission, a literal construction given to Section 6(b) would render it impractical and ineffective. Mr. Justice Brandeis for a unanimous court disposed of this contention in the following succinct and signficant paragraph (p. 237):

> "It would be inappropriate for us to discuss these, and other, arguments presented. The language of § 6 (b) is clear; and on the face of the statute, there can be no doubt concerning the intention of Congress. As was said in *Iselin* v. *United States,* 270 U. S. 245, 250-251: 'The statute was evidently drawn with care. Its language is plain and unambiguous. What the Government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably (possibly) by inadvertence, may be included within its scope. To supply omissions transcends the judicial function.' "

The words of Section 115(f) of the Revenue Act of 1928 decree an exemption for all stock dividends, irrespective of class or category. They must be obeyed. Otherwise, taxpayers will have been misled for a period of fifteen years.

II.

The Legislative History of the Provision Confirms Its Literal Meaning.*

Eisner v. *Macomber,* decided on March 8, 1920, was received alike by those who acclaimed and those who deplored it as standing for the proposition that payment from the corporate treasury is an indispensable incident of a taxable dividend.

> "The essential and controlling fact," run the celebrated words of Mr. Justice Pitney, "is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains

*The rule restricting the use of debates does not apply when the purpose is to sustain the literal meaning of a statute. *United States* v. *Missouri Pacific Railroad Company,* 278 U. S. 269, 278.

Use of debates is proper also to show the circumstances prompting the legislation. *Humphrey's Exec.* v. *United States,* 295 U. S. 602, 625; *Federal Trade Commission* v. *Raladam,* 283 U. S. 643, 649-650.

> the property of the company, and subject to business risks which may result in wiping out the entire investment." *Eisner* v. *Macomber,* 252 U. S. 189, 211.

Authorities on constitutional law were unanimous in their construction of the decision. Writing in the Columbia Law Review for May 1920, (Vol. 20, p. 536) Professor Thomas Reed Powell declared at pages 542, 545:

> "The determining reason why a stock dividend is not income is that the corporation parts with nothing. Its assets remain intact. Therefore, a stockholder gets nothing . . . "
>
> . . . . .
>
> "So on the question of precedent and legal analysis the line of division is whether the corporation parts with assets. What is income to the stockholder depends upon what is outgo to the corporation. The majority plant themselves firmly on this ground."

In 21 Columbia Law Review 313 (1921), Mr. Eustace Seligman, analyzing the implications of *Eisner* v. *Macomber,* observed at pages 318, 319:

> "So far as the economic principle in question is concerned, all such cases resolve themselves into the simple question: Has something been taken from the corporation's assets and given to the stockholders. If so, the stockholder has received income; if not, he has not received income.
>
> . . . . .
>
> "Another application of this test of separation is that stock dividends payable to preferred stockholders are not income . . . When such stock dividends are declared, the preferred stockholders are enriched to just the same extent as if they received cash; they have received valuable new rights. Yet on the payment-from-treasury test of income, we are forced to the conclusion that they have received no income.
>
> "Another similar application of this principle is where a dividend to common stockholders is paid in preferred stock, when there has already been a pre--

existing preferred stock outstanding owned by others . . . upon the Court's test of separation, there is no income because nothing has been taken from the corporate treasury."

Writing in 35 Harvard Law Review, 363, in February 1922, Professor Powell endorsed Mr. Seligman's views (p. 377):

"Mr. Seligman is sound in his analysis that the separation test of the Stock Dividend Decision precludes the imposition of an income tax on dividends in preferred stock or in bonds of the declaring corporation . . .".

Similar opinions were voiced by Professor Charles E. Clark in an article entitled "*Eisner* v. *Macomber* and More Income Tax Problems", 29 Yale Law Journal 735, May 1920:

"The long awaited decision of the United States Supreme Court in *Eisner* v. *Macomber,* (1920) 40 Sup. Ct. 189, has aroused perhaps more interest than is merited by the actual decision, which is simply that dividends of a corporation declared by issuing its own stock are not income within the meaning of the Sixteenth Amendment."

Economists concurred with lawyers in their interpretation of the decision. Professor F. R. Fairchild of Yale, discussing the stock dividend decision in 5 Bulletin National Tax Association, pages 208, 210 (1920), remarked:

"Has something been taken from the corporation's assets and given to the stockholders? If so, the stockholder has received income; if not, he has not received income."

Congress itself was not slow to react to the impelling mandate of Mr. Justice Pitney's language. On May 22, 1920, a bill was introduced in the House of Representatives (H. R. 14197, 66th Congress, 2nd Session) carrying an

amendment to Section 201 (c) of the Revenue Act of 1918, providing as follows:

> "A dividend paid in stock of the corporation (hereinafter called 'stock dividend') shall not be subject to tax at the time of distribution."

The discussion on the floor on May 27, 1920, gives content to the words of the section (Cong. Rec., Vol. 59, pp. 7759-7760).

> MR. GREEN of Iowa [Ranking majority member of the Ways and Means Committee]. In view of the decision. It is the logical result of the decision in the Stock Dividends case. That case, I might say, declared in effect that a stock dividend could not be taxed, because it was not in fact a distribution of any property of the corporation. . . .
>
> . . . . . .
>
> MR. WINGO. Does the gentleman care to state—a good many people are inquiring—what is the probability of legislation that might reach the stock dividends that would be compatible with the decision of the Supreme Court? Is there any probability of that?
>
> MR. GREEN of Iowa. We have in the Soldiers' Adjusted Compensation Bill a provision about which I think there is no question as to constitutionality. It does not tax the stock dividend, however, in the hands of the party to whom it is issued but puts an excise tax on the corporation issuing the stock dividend.
>
> MR. WINGO. If it is issued, you put an excise tax on the issuance of that stock?
>
> MR. GREEN of Iowa. Yes; but that is not in this Bill.

It appears, therefore, that the House was satisfied the Supreme Court decision had completely deprived it of the power of treating a stock dividend as taxable income to the recipient. Its hope of recouping the revenue loss caused thereby lay in a different direction—the possibility of imposing a corporate excise tax on the issuance of stock dividends.

Although H. R. 14197 did not pass the Senate, its history reveals the state of the legislative mind as well as the interpretation commonly placed upon *Eisner* v. *Macomber*. The taxation of all stock dividends as income was thought to have been outlawed.

The reluctance of Congress to grant the immunity, with the clear inference that Congress granted it in unlimited form only because it believed *Eisner* v. *Macomber* left no alternative, is even more evident in a contemporaneous Senate debate. Representatives and Senators chafed under the immunity and acceded only on the assurance that the Supreme Court decision left no alternative except complete exemption of stock dividends. (Cong. Rec., Vol. 59, p. 7289-7290):

> MR. NELSON. If I understand the decision of the Supreme Court correctly, it practically holds that we have no right to tax stock dividends for the reason that they are capital. . . .
>
> . . . . . .
>
> MR. THOMAS. The majority opinion of the Supreme Court also holds that the transformation of income into capital stock relieves it from the burden of further taxation as income; in other words, that as soon as the transformation is complete then the fund becomes capital and ceases to be income. . . .
>
> MR. KENYON. . . . There ought to be some way of reaching those stock dividends. If the distinguished Senator from Colorado [Mr. Thomas], one of the ablest lawyers in this body, and I would say one of the greatest Senators who ever sat in this body, cannot devise some way in the Finance Committee—he was a member of that Committee when the present law was framed—to cover this question, I would despair of its being covered; but it does seem as if there should be some way of reaching the question. . . .

In the House on August 18, 1921, when the Revenue Act of 1921 was under consideration, the following colloquy occurred (Cong. Rec., Vol. 61, p. 5287):

MR. GREEN. [Ranking majority member of the House Ways & Means Committee] I explained the previous amendment very clearly, to the effect that we could not tax stock dividends any more on account of the Supreme Court decision. . . .

. . . . . .

MR. LONDON. What has the Committee substituted for the stock dividends?

MR. GREEN. We have not substituted anything.

MR. LONDON. There was no effort made to reach the stock dividends?

MR. GREEN. There is no way in which the stock dividends can be taxed under the Supreme Court decision. A different kind of a tax, of course, could be imposed.

MR. LONDON. But the Committee has not found any way to do so?

MR. GREEN. No.

In the Senate on October 19, 1921, similar sentiments were voiced. (Cong. Rec., Vol. 61, pp. 6473-6474.)

MR. NELSON. . . . stockholders of these wealthy corporations got relief under the decision of the Supreme Court holding stock dividends to be immune from taxation. Where these big companies now have big earnings, instead of distributing dividends in the shape of cash they can issue more stock, and under the decision of the Supreme Court, a 5 to 4 decision, they can escape taxation on that stock. If a dividend is paid in cash, it is taxable. If additional stock is issued—and we have cases here where they have issued eight, nine, and ten hundred per cent of stock dividends—they are immune from taxation.

. . . . . .

Mr. President, I certainly think we ought to have legislation that would put stock dividends on a par with cash dividends. . . . I have been in hopes that there would be something in this Bill which would cover that question. I think it can be covered by proper legislation.

I have inquired of the members of the Committee, and I have inquired of some of the experts we have here, whether there is a provision made for it in the

bill, and I am told that there is not. I think one of the great lapses and oversights in the bill is that it does not seek to overcome the vice of that decision of the Supreme Court of the United States about stock dividends.

MR. MCCUMBER [Ranking majority member of Finance Committee]. *If the Senator will read the Supreme Court decision carefully, he will find that the reason given for holding that you could not levy a tax upon the undistributed profits of a corporation even though they were in the form of dividend certificates, was that the taxpayer was not in possession and control of the funds, and he could not be taxed upon funds which were not his, and over which he had no control.* That was the basis of the decision, and that being the basis of the decision, you could not by any character of language tax those funds while they were still in the hands of the corporation. You could not tax them as against the holder of the certificates. *That, I think, was the reason which actuated every member of the committee, so far as I know.* The Senator from New Mexico, perhaps, was not present when that was passed upon. [Italics supplied]

Two minority reports were written in the Senate Finance Committee when the Revenue Act containing the stock dividend exemption was returned to the Senate, bitterly assailing the Bill for shifting the tax burden from those best able to bear it. S. Rep. No. 275, 67th Cong., 1st Sess. But not one word was addressed to the all-embracing scope of the stock dividend provision. Not one word was uttered to the effect that the provision was broader than it needed to be under *Eisner* v. *Macomber*. Would this gap have gone unchallenged if there were the slightest belief on anyone's part that there was any gap? The inevitability of exempting all stock dividends was the force moving Congress to approve the exemption.

The suggestion that the mind of Congress did not advert to the possibility of other types of stock dividends than common shares distributed to common stockholders involved in *Eisner* v. *Macomber* and that, therefore, the

words "stock dividend" merely embody such stock dividends as were known at the time, is confuted not only by the intervening Treasury Department rulings which specifically dealt with dividends in different classes of stock, but indeed by the dissenting opinion of Mr. Justice Brandeis in *Eisner* v. *Macomber*, 252 U. S. 189, which discussed in some detail, on page 227, the taxability of dividends paid in preferred stock to common stockholders. In spite of this caveat, the language of the majority opinion seemed so overwhelming that it is little wonder Congress did not see fit to constrict the exemption. In any event, no one can be heard to say that Congress legislated without knowledge of the existence of other forms of stock dividend than the familiar variety of common on common.

The character of the earlier exemption is brought into bold relief by the Revenue Act of 1936 which, in Section 115 (f) (Act of June 22, 1936, c. 690, 49 Stat. 1648), changed the language which had been in the Revenue Act since 1921. That section provided:

> (1) *General Rule.* A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

The specific recognition contained in this section of the different types of stock dividends, and the specific limitations of the tax exemption to the stock dividends which were constitutionally exempt—both features of which are new in the 1936 Act—are strong additional evidence that a change was intended in the 1936 Act. *Brewster* v. *Gage*, 280 U. S. 327; 337; *Johnson* v. *United States*, 225 U. S. 405, 415; *Crawford* v. *Burke*, 195 U. S. 176, 190; *Pirie* v. *Chicago Title & Trust Co.*, 182 U. S. 438, 448. And a change in the law can mean only that the prior laws intended a full exemption of all stock dividends.

It is true, of course, that this rule of construction is not always applicable, if other evidence indicates that the purpose of the change of expression was merely the clarification of existing law. *Helvering* v. *New York Trust Co.*, 292 U. S. 455, 468-469. The Government attempts, by the debates in Congress, (Br. No. 27, p. 20) to prove that such was the purpose of the change in the 1936 Act. We submit that, in fact, the debates, as well as the Act itself, make it abundantly clear that the language of Section 115 (f) was changed in order to remove an existing exemption, not to clarify it.

The Government relies, (Br. No. 27, p. 20) on the statement by Representative Vinson on April 28, 1936 (Cong. Rec., Vol. 80, p. 6309):

> The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.

Literally, the statement does not support the Government's argument, for it states simply that the law remains unchanged in respect of a stock dividend where there is no change in the proportion of ownership—*i. e.*, where, even under the *Koshland* decision, the stock dividend is constitutionally exempt. The attempt of the Government to torture it into a statement that the law was not changed by the 1936 Act *in any respect* is refuted not only by the context of the particular statement, but also by other remarks by the same Representative.

The full discussion during which the statement relied on by the Government was made is as follows. The italicized portion, which follows that paragraph upon which the Government relies, reveals the true meaning of Representative Vinson's remark (Cong. Rec., Vol. 80, pp. 6309-6310):

> MR. TREADWAY. . . . Now, referring to section (f), taxable stock dividends, which is, of course, entirely

new, that is, the principle is entirely new in that there is a set-up there under which stock dividends can be taxed which has not been in the previous law. I am correct in that?

MR. VINSON OF KENTUCKY. If the gentleman from Massachusetts will permit, under the 1934 act there was a provision that said no stock dividend should be taxed. In a very celebrated case, Eisner against Macomber, the Supreme Court held that the tax dividend involved in that case was not taxable. Out of that case grew up the idea that no stock dividend was taxable. I think it was because of that notion that the language to which I have referred, as appears in the 1934 bill, found its way there; that is, that no stock dividend should be taxed.

The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder.

MR. TREADWAY. The language stricken out, I may say, reads as follows:

> (b) Stock dividends: A stock dividend shall not be subject to tax.

That is the existing law and has been the law most of the time since the Eisner against Macomber decision. In the next tax bill after that decision that language was included.

I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

MR. VINSON OF KENTUCKY. *That is correct.*

MR. TREADWAY. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?

MR. VINSON OF KENTUCKY. Well, we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxa-

> tion, and if there are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes.
>
> . . . . . .
>
> MR. TREADWAY. Therefore, the language is drawn with the view of complying with conditions under which the sixteenth amendment is applicable.
>
> MR. VINSON OF KENTUCKY. The gentleman states it in a nutshell. [Italics supplied]

Moreover, there had been a discussion of the new Section 115 (f) on May 27, the previous day. In that discussion Representative Vinson stated, beyond all shadow of doubt, that he understood the 1936 Act to change the prior law (Cong. Rec., Vol. 80, p. 6214):

> MR. VINSON OF KENTUCKY. . . . Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. *Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill.* There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.
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> The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. . . . [Italics supplied]

The Senate likewise understood that the exemption was being narrowed by the 1936 Act. On June 3, after the *Koshland* decision, Mr. Justice Black, then Senator, in discussing the dividends paid credit provision of the 1936 Bill, stated (Cong. Rec., Vol. 80, p. 8811):

> MR. BLACK. . . . As all Senators know, until about two weeks ago it was generally believed that it was impossible to tax stock dividends as income of the recipient of those stock dividends. About two weeks ago, however, the Supreme Court of the United States rendered an opinion which appeared in the Record, in

> which it decided if those stock dividends were declared in a different type of stock than the stock which was originally held by the owner, that those dividends did constitute actual income—taxable income, if you please—in the hands of the stockholder recipient.
>
> That being true, we have provided in such manner as to avoid any possible misunderstanding, that stock dividends declared in such manner that they are taxable in the hands of the recipient will be considered as distributed profits against which no undistributed-profits tax is imposed. . . .

Decisive proof of an intention to change the existing law is furnished finally by the language of the 1936 Act, which, in Section 115 (h), Act of June 22, 1936, c. 690, 49 Stat. 1648, provides:

> The distribution . . . by or on behalf of a corporation of its stock . . . shall not be considered a distribution of earnings or profits of any corporation. . . .
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> . . . . . .
>
> (2) If the distribution was not subject to tax in the hands of the distributor because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution *or* because *exempt to him under Section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.* [Italics supplied.]

All the evidence, therefore, points irresistibly to the conclusion that Congress intended in 1921 to exempt all stock dividends from income tax. The Government, however, argues that even on this state of facts the exemption should be narrowed to those stock dividends which are constitutionally exempt under the *Koshland* decision. The contention, simply stated, is that Congress, in enacting Section 201 (d) of the 1921 Act, and Section 115 (f) of the 1928 Act, intended to exempt those stock dividends which were constitutionally exempt; that, under a misapprehension of its

power, it made the exemption too wide; but that now, its power having been clarified, only those stock dividends which are now known to be constitutionally exempt are within the statute.

The simple answer to the contention lies in the fact that the Government's theory attempts to impart to the Congress of 1921 information which it did not have, and consequently interprets the statute in the light of later events, rather than in the light of circumstances as they existed, or were assumed to exist, at the time the statute was passed. It may be conceded that if Congress had known in 1921, or 1928, what it knows now, it would have passed the statute in the form of the Revenue Act of 1936 (*supra*, p. 15). This Court, however, has denied many times that a misapprehension by Congress of the facts which form the basis for its legislation justifies a court in engaging in an act of judicial amendment.

A similar situation was considered in *Merritt* v. *Welsh*, 104 U. S. 694. There Congress had classified sugar for import duty on the basis of the place of the sugar in the Dutch standards of color. The Treasury Department, finding that standard unsatisfactory, applied a chemical test. The Court said (p. 700):

> "Perhaps Congress may have acted under a mistaken idea that color would always indicate quality. Perhaps, up to the time that the law was passed, as the process of manufacture had been conducted, color was an approximate, or general, indication of quality. Suppose this to be so, does it derogate from the fact that color was the standard which Congress, with the lights which it had, saw fit to adopt? Does it not tend to fortify that fact? If it be found by experience that the standard is a fallacious one, can the executive department supply the defects of legislation? Congress alone has the authority to levy duties. Its will alone is to be sought."

Platt v. *Union Pacific R. R. Co.*, 99 U. S. 48, involved the scope of a land grant, made 16 years before, designed to

advance the building of the first transcontinental railroad. In answer to an argument similar to that made by the Government in the present case, the Court said (pp. 63-64):

> "There is always a tendency to construe statutes in the light in which they appear when the construction is given. It is easy to be wise after we see the results of experience. We may now think it quite possible the lands could all have been sold before July 1, 1877. The unforeseen success of the enterprise and the unprecedented rush of emigration along the line of the railroad have shed new light upon the value of the grants made to the company. But in endeavoring to ascertain what the Congress of 1862 intended, we must, as far as possible, place ourselves in the light that Congress enjoyed, look at things as they appeared to it, and discover its purpose from the language used in connection with the attending circumstances."

It will be profitable also to consider the following quotation from *County of Schuyler* v. *Thomas*, 98 U. S. 169, 172:

> "These statutes are to be construed as they were intended to be understood when they were passed, twenty years since. The after-wisdom, obtained by unfortunate results, cannot justly be applied in their interpretation. A construction may *now* be sought which will avoid the payment of the debts contracted for building the road. *Then* every inducement was presented to make subscriptions and obtain the money. Little respect would have been paid to the careful legislator or the strict interpreter of the law, who, twenty years ago, had doubted the power of these counties to make the subscription in question."

See also *United States* v. *Smith*, 197 U. S. 386, 392-393; *Illinois Central R. R. Co.* v. *A. Waller & Co.*, 164 F. 358, 360-361 (C. C. W. D. Ky. 1908); *People ex rel. Fyfe* v. *Barnett*, 319 Ill. 403, 408-409; *In re Bergeron*, 220 Mass. 472, 475; *Werner* v. *Hillman Coal & Coke Co.*, 300 Pa. 256, 262.

In the *Merritt* case, for example, the argument made by the Government in this case was equally applicable—Con-

gress intended to graduate the tariff on sugar on the basis of quality; it was, in light of later events, mistaken as to the best way to measure that quality; therefore, the Court should apply the new test to give effect to the intention of Congress. The argument was rejected there, and it should, likewise, be rejected here.

If Congress chose a narrower view of its power than was necessary, the Court should await the will of Congress to expand that power as, indeed, it was manifested in 1936. In 1921 Congress did mean the exemption to apply to all stock dividends, even though such intention may have been unnecessary or unwise. If the legislature intends a statute to apply to a given situation, a court will never substitute its own desire, no matter how misguided the legislature may have been.

The entire life of the provision, "A stock dividend shall not be subject to tax", beginning with its birth out of *Eisner* v. *Macomber* and ending with its death from *Koshland* v. *Helvering,* reveals an unmistakable purpose to exempt all stock dividends from income taxation. Not a single circumstance is at war with this conclusion. Not a single token points in an opposing direction. We can well accept the proposition of Judge Learned Hand, dissenting in the court below, that the true way of finding out what words really mean is "to reinstate the circumstances in which they were uttered and discover how much a reasonable person would have understood them to include." In fact, the reinstatement of those circumstances forms the very foundation of our position.

Both the majority and minority opinions in *Koshland* v. *Helvering,* 298 U. S. 441, sanction the interpretation which we urge. In the former, Mr. Justice Roberts declared (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, *the Treasury gave the decision a broader interpretation which Congress*

followed in the Act of 1921. Soon after the passage of that Act, this court pointed out the distinction between a stock dividend which worked no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the stockholder after the distribution was essentially different from the former interest. Nevertheless the successive statutes and Treasury regulations respecting taxation of stock dividends remained unaltered." [Italics supplied.]

Mr. Justice Stone and Mr. Justice Cardozo in their dissenting opinion stated (p. 447):

> "Congress did not intend, however, when it refused to tax the newly acquired shares as income *in praesenti* to exclude them from taxation *in futuro* if disposed of at a profit."

We submit, therefore, that effect should be given to the statute according to its terms, and all stock dividends should be declared exempt from income taxes under Section 115 (f) of the Revenue Act of 1928.

Respectfully submitted,

J. Harry Covington,
John Thomas Smith,
Paul E. Shorb,
David Sher.

Washington, D. C.,
October 19, 1937.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Annie M. Pfeiffer. | On Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 6, 1937.]

Mr. Justice Brandeis delivered the opinion of the Court.

This case presents questions of income taxation applicable to stock dividends.

In 1931, Annie M. Pfeiffer, a holder of common stock in William R. Warner Corporation, received as a dividend thereon 6,291¼ shares of its preferred stock. She also received from the corporation in that year $200,000 cash in exchange for 2,000 shares of its preferred stock which she had received as a dividend in 1928. In her income tax return for 1931, she did not include as taxable income either the preferred stock or the $200,000 cash. She did not include the preferred stock received in that year, because she deemed it exempt from taxation under § 115 (f) of the Revenue Act of 1928. She did not include the $200,000 cash as taxable income, because she considered it the proceeds from the sale of a capital asset. But she did include $180,100 thereof as taxable capital gain on the sale, computing the gain in accordance with the then effective Treasury Regulations. And she paid a tax of $22,512.50 on such capital gain.

The Commissioner assessed a deficiency on each item. He determined that the 6,291¼ shares of preferred stock valued at $629,125, were taxable income of 1931, because not exempt under § 115 (f); and that the $200,000 cash were the proceeds of a redemption under § 115 (g), and hence taxable income. He eliminated the taxable capital gain reported and assessed a deficiency on each of the items.

The taxpayer sought a review by the Board of Tax Appeals. It affirmed the Commissioner's determination that the preferred stock

received in 1931 was taxable income; but reversed his determination as to the proceeds of the 2,000 shares, and said:

"The Commissioner held that the redemption of the 2,000 shares in 1931 was at such time and in such manner as to be substantially equivalent to a taxable dividend in 1931, within the meaning of section 115 (g) of the Revenue Act of 1928. He erred in this since the distribution was subject to tax as a dividend in 1928 (see cases above cited). Thereafter the shares had a basis for gain or loss to the petitioner of $100 each, and they were redeemed without gain or loss to the petitioner at $100 each in 1931."

The Commissioner acquiesced in the Board's decision. The taxpayer sought a review by the Circuit Court of Appeals. It reversed the Board's decision as to the 1931 stock dividend, on the ground that § 115 (f) exempted that dividend from taxation; and it affirmed the Board's decision that the $200,000 cash was not taxable income of 1931, saying (88 F. (2d). 3, 5):

"The appellee argues that the proceeds from the redemption in 1931 of 2,000 shares of preferred stock distributed as a stock dividend in 1928 should be considered either (a) subject to a tax as a capital gain or (b) subject to taxation as the equivalent of the distribution of a taxable dividend pursuant to section 115 (g) of the Revenue Act. The question of taxability as capital gain of the $200,000 or any part thereof was not in issue before or decided by the Board of Tax Appeals. The contention that we have authority to sustain the deficiency pro tanto even though the issue was not raised before the Board nor decided by it nor assigned as error in the petition to this court for a review of the Board's decision is untenable. General Utilities & Operating Co. *v.* Helvering, 296 U. S. 200, * *; Helvering *v.* Salvage, 297 U. S. 106, * *. The Board held that this stock dividend redeemed in 1931 at $100 per share was taxable in the year 1928 when received and was therefore not taxable under section 115 (g); that it had a basis for gain or loss of $100 per share; and that therefore there was no taxable income from the redemption. The Commissioner did not file a cross-appeal. By the provisions of section 115 (g) the proceeds of the redemption of the stock can be taxed only if it occurs at such time and in such manner as to make the redemption essentially equivalent to the distribution of a taxable dividend. Since the Board did not so find, we cannot support this contention."

The Commissioner's petition for certiorari was granted in connection with that in *Helvering* v. *Gowran*, No. 27, decided this day.

First. As to the 1931 dividend in preferred stock, the Commissioner contends that the immunity from taxation conferred by

§ 115 (f) did not extend to it. We hold, for the reasons stated in Paragraph First of *Helvering* v. *Gowran*, that it was exempt from taxation.

Second. As to the $200,000 received in 1931, the Commissioner contends that the Circuit Court of Appeals erred in failing to hold it taxable income, since under the rule declared in *Helvering* v. *Gowran*, the cost was zero.

We are not at liberty to entertain that contention. The Board of Tax Appeals decided that the $200,000 was not taxable income of 1931. As the Commissioner did not seek a review of that decision, which was adverse to him, the Circuit Court of Appeals properly refused to consider the contention. *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206. While a decision below may be sustained, without a cross-appeal, although it was rested upon a wrong ground, see *Helvering* v. *Gowran*, an appellee cannot without a cross-appeal attack a judgment entered below. Compare *United States* v. *American Railway Express Co.*, 265 U. S. 425, 435; *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U. S. 185.[1] The same rule applies to a decision of the Board of Tax Appeals.

Third. The Commissioner requests that, if we hold that the Board erred in declaring that the 2,000 shares received in 1928 were then taxable and refuse to review its decision that the proceeds received in 1931 were not taxable, we should remand the case to the Board to determine whether redemption of the 2,000 shares was made at such time and in such manner as to be essentially equivalent to the distribution of a taxable dividend under § 115 (g). The Commissioner acquiesced in the decision of the Board. No good reason is shown for disturbing it.

Affirmed.

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[1] See also The Stephan Morgan, 94 U. S. 599; Mount Pleasant v. Beckwith, 100 U. S. 514, 527; United States v. Blackfeather, 155 U. S. 180; Landram v. Jordan, 203 U. S. 56; Southern Pine Lumber Co. v. Ward, 208 U. S. 126, 137; Fitchie v. Brown, 211 U. S. 321, 329; Bothwell v. United States, 254 U. S. 231.

SUPREME COURT OF THE UNITED STATES.

No. 29.—October Term, 1937.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Annie M. Pfeiffer. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 6, 1937.]

Mr. Justice Stone and Mr. Justice Cardozo think the judgment should be reversed.

The issue before the Board of Tax Appeals was the existence of a deficiency in respondent's income tax for a single year, 1931. The deficiency fixed by the commissioner represented her net tax liability for that year and drew in question every item which entered into computation of the tax. *Lewis* v. *Reynolds*, 284 U. S. 281, 283. Her appeal to the board drew in question her net tax liability on a reexamination of every item of income in that year which she had challenged in her petition. The commissioner had treated as taxable income of respondent two items, both received in that year, and assessed a deficiency accordingly. They were a dividend paid to the taxpayer in preferred stock, and cash received by her in that year upon the redemption of preferred stock received as a dividend in an earlier year. The Board of Tax Appeals thought respondent was taxable in 1931 on the first but not on the second item, and reduced the deficiency accordingly. It "Ordered and decided, that there is a deficiency for the year 1931 in the amount of $89,841.75."

This Court, upon consideration of the facts stipulated by the parties and found by the board, holds that respondent was taxable upon the full amount of the item of cash received but not upon the stock dividend. But, because the commissioner took no appeal from the order of the board, the Court declines to give any effect to its ruling that the cash is taxable income in 1931. If the commissioner had sought only to increase the deficiency found by the board, it may be conceded that the point would be well taken, but such is not his purpose. On the contrary, he accepts the order and relies upon

it as establishing a deficiency of which he asks the benefit only so far as it is sustained by the application, to the facts found, of the rule of law announced by this Court.

The circumstance that the board, by the erroneous application of a rule of law to the facts before it arrived at a deficiency which is sustained by a correct application of a different rule, is not ground for setting aside its order. *Langnes* v. *Green*, 282 U. S. 531, 538-539; No. 12, *Anderson, Receiver* v. *Atherton, Administrator*, decided October 18, 1937; compare *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U. S. 185. In denying to the commissioner any benefit of the order because he did not appeal, the opinion of the Court gives no hint of any ground upon which the commissioner should or could have appealed so far as the order fixes a deficiency which the record shows is lawfully due or why the respondent is not free to maintain that the board reached the right result even though the reason it gave was wrong.

The cause should be remanded to the Board of Tax Appeals to recompute the deficiency in conformity with the rule of tax liability laid down in the opinion of this Court, but in an amount not exceeding that which the board has found.

General Utilities & Operating Co. v. *Helvering*, 296 U. S. 200, does not require any different result. There it was held that it was error for the circuit court of appeals, on an appeal by the commissioner to reverse an order of the board and remand the cause for new findings to support a theory of tax liability which first emerged from the case on appeal. Here there is no new issue to be tried by the board. The only issue is one of law which this Court has resolved and which has been implicit in the case from the beginning.